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Fiscal Accountability of the Nation's Energy Resources



January 1982

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Commission on Fiscal Accountability
of the Nation's Energy Resources

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David F. Linowes
Chairman

January 21, 1982

Michel T. Halbouty
Mary Gardiner Jones
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Ernest B. Staats

The Honorable James G. Watt
Secretary of the Interior
Washington, D.C. 20240

Dear Mr. Secretary:

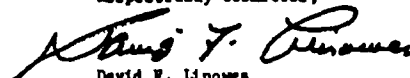
I am pleased to transmit to you the report of the Commission on Fiscal Accountability of the Nation's Energy Resources.

During the past six months, the Commission has investigated the serious allegations of massive irregularities in royalty payments due the Federal government, Indian tribes, and States; and the allegations of theft of oil from Federal and Indian lands. From the outset and throughout our deliberations, we have sought and obtained the active participation of all those having particular interests in our findings: State officials, Indian tribes, oil and gas companies, United States Geological Survey and others within the Department of the Interior, General Accounting Office, and committees of Congress, among others.

In its work, the Commission has maintained a position of independence and objectivity, giving full and balanced consideration to all points of view. We believe our findings give a comprehensive and fair analysis of the conditions and relationships that now prevail within and among the institutions involved in royalty management. It is the unanimous judgment of the Commission that if the accompanying recommendations are adopted, a major step will have been taken to bring full and proper accountability to the management of Federal royalties.

Participation in the work of the Commission has been a challenging opportunity to serve our Nation, and to join in the President's attack on fraud, waste and inefficiency in the Federal government. We appreciate having this privilege.

Respectfully submitted,


David F. Linowes
Chairman



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The Honorable Edwin L. Harper
Assistant to the President
Chairman,
Council on Integrity and Efficiency
The White House
Washington, D.C.

Dear Mr. Harper:

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Respectfully submitted,

A handwritten signature in dark ink, appearing to read "David F. Linowes".
David F. Linowes
Chairman

COMMISSIONERS

David F. Linowes (Chairman)

Mr. Linowes is the Boeschenstein Professor of Political Economy and Public Policy at the University of Illinois, and was Chairman of the U.S. Privacy Protection Study Commission from 1975 to 1977. He is former Chairman of the Trial Board, American Institute of Certified Public Accountants, and has headed economic development missions to Turkey, India, Greece, Pakistan, and Iran on behalf of the U.S. Department of State and the United Nations.

Michel T. Halbouty

Mr. Halbouty is an independent oil producer and operator and holds advanced degrees in both geology and petroleum engineering. He has served as President of the American Association of Petroleum Geologists.

Mary Gardiner Jones

Ms. Jones is a former Federal Trade Commissioner and is President of the Consumer Interest Research Institute. Currently she is Vice-President for Consumer Affairs for Western Union Telegraph Co. Ms. Jones is a lawyer and has served with the Department of Justice in New York City.

Charles J. Mankin

Mr. Mankin is Director of the Oklahoma Geological Survey, Executive Director of the Energy Resources Center, and Professor of Geology at the University of Oklahoma. He was President of the American Geological Institute, and Chairman of the Board of Mineral and Energy Resources of the National Academy of Sciences.

Elmer B. Staats

Mr. Staats was Comptroller General of the United States from 1966 to 1981. Previously he served as Deputy Director of the Bureau of the Budget and Executive Director of the Operations Coordinating Board of the National Security Council.

COMMISSION STAFF

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Mr. Elkins has served for more than ten years as a senior manager in the Federal government. He has a degree from Yale Law School and is a member of the District of Columbia Bar.

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¹On loan from the Solicitor's Office, U.S. Department of the Interior

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TABLE OF CONTENTS

Preface	xi
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Summary	xv
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CHAPTER

1	Introduction	3
2	The Problems	13
3	Internal Controls	43
4	Site Security	83
5	Enforcement	99
6	States and Indian Tribes	115
7	Organizational Issues	141
8	New Approaches to Royalty Management	165
9	Summary of Recommendations	237

APPENDICES

A	Charter of the Commission	271
B	Witnesses Who Testified at Commission Hearings	275
C	Congressional Hearings	285
D	Selected Previous Studies of Royalty Management	291
E	Selected Audits of Federal and Indian Leases	305
F	Source and Disposition of Royalties	313

TABLE OF CONTENTS (CONTINUED)

G	Responsibilities of the Conservation Division, USGS	321
H	Responsibilities of the Bureau of Indian Affairs	325
INDEX	331

PREFACE

The Commission on Fiscal Accountability of the Nation's Energy Resources has completed the tasks established for it in its Charter of July 8, 1981. Those tasks were:

- ° To examine the allegations of massive irregularities in royalties on the Nation's energy resources which are owed to the Federal government, Indian tribes, and States;
- ° To investigate the allegations of theft of oil from Federal and Indian lands; and
- ° To make recommendations for improving fiscal accountability of the Nation's energy resources.

The Commission's findings and recommendations are set forth in this report. Each of the recommendations was adopted unanimously by the Commission.

The Commission could not have completed its work on these complex and urgent matters in a timely fashion without the active cooperation of a great many people and institutions. Throughout the life of the Commission, our activities were coordinated with the President's Council on Integrity and Efficiency in Government. We received unstinting help from the Department of the Interior; from other government agencies, such as the General Accounting Office, the Internal Revenue Service, and the Office of Management and Budget; as well as, from Members of Congress and their staffs.

The Commission was also aided immeasurably by States, Indian tribes, the oil and gas industry, and private citizens who appeared before the Commission at five sets of comprehensive public hearings. Many of those testifying provided followup assistance as well.

We are also indebted to scores of other individuals who gave their time and professional expertise. We particularly want to recognize the competent contributions and unfailing assistance of William L. Kendig, Director of Financial Management of the Department of the Interior, and Wiley W. Horsley, Jr. and Richard E. Powers of that office. Milton J. Socolar, John F. Simonette, Jeffrey C. Steinhoff, and Darby W. Smith of the General Accounting Office were most responsive to the Commission's needs. Dallas L. Peck, Doyle G. Frederick, R. Michael Gall, and J. Ronald Jones of the U. S. Geological Survey all cooperated generously and graciously.

Our staff, led by its Executive Director, Charles L. Elkins, performed with unusual devotion to our demanding schedule. Our sincere appreciation to each of them.

Finally, the Commission wishes to acknowledge that much of its effort rests on a body of work on oil and gas royalty management completed over the last twenty years by the General Accounting Office, the Department of the Interior, and various Congressional committees.

The Commission's charge broadly covers the Nation's energy resources, which include hard mineral energy resources such as coal and uranium as well as oil and gas. We are aware of problems in the management of coal and uranium royalties, and these are briefly addressed in Chapter Eight of this report. But for the present and the near future, oil and gas are dominant, providing 97 percent of the royalties from Federal and Indian energy resources. For this reason, this report essentially is focused on oil and gas.

The Commission has viewed its efforts as contributing to the prudent management of the country's energy resources, and to stopping any loss of revenues rightly due to the Federal government, the States, and Indians. Equally, we recognize that democratic institutions rest on a foundation of faith in the competence and accountability of government. We believe that the measures recommended by this Commission can help to strengthen that faith.

David F. Linowes
Chairman

SUMMARY

Management of royalties for the Nation's energy resources has been a failure for more than 20 years. Because the Federal government has not adequately managed this multibillion dollar enterprise, the oil and gas industry is not paying all the royalties it rightly owes.

The government's royalty recordkeeping for Federal and Indian oil and gas leases is in disarray. For this reason, the exact amount of underpayment is unknown. The results of individual audits, which have often uncovered large underpayments, suggest that hundreds of millions of dollars due the U.S. Treasury, the States, and Indian tribes are going uncollected every year.

In addition, oil thefts are occurring on Federal and Indian leases. The extent of theft and the amount of royalty losses from theft are unknown, but it is well-documented that security at many Federal and Indian lease sites is lax and is an open invitation to theft.

The Nation can no longer afford mismanagement of royalties for its energy resources. The stakes are too high. With the rapid escalation of energy prices, oil and gas royalties have risen from less than \$500 million in 1971 to more than \$4 billion in 1981.

The government's royalty management system needs a thorough overhaul. This report of the Commission on Fiscal Accountability of the Nation's Energy Resources details 60 specific recommendations (listed in Chapter Nine of the report) for revising and rebuilding the system. Underlying these recommendations are some fundamental conclusions the Commission reached in the course of its intensive inquiry:

- ° The government's royalty management system must have qualified managers. The scientifically oriented Geological Survey, which now manages royalties, has never been able to supply the active, sophisticated management that is needed. It is largely for this reason that the Commission recommends removing the royalty management function from the Geological Survey. In a separate office with a clearly defined mission, royalty management could attract managers with the training and experience required.
- ° The Federal government should work more closely with States and Indian tribes. In fulfilling its royalty management responsibilities, it should cooperate much more than it has in the past with States and Indian tribes, sharing both information and specific tasks, such as auditing and site inspection.
- ° The Federal government should perform an oversight role. It must not waste its limited resources on tasks that are industry's responsibility. In managing royalty collection, it should not remain mired in bookkeeping details that rightly belong to the lessee. Instead, it should develop systematic, independent cross checks of royalties paid and reports submitted by companies, and it should impose meaningful penalties for false statements or gross errors. In helping to prevent theft, the government should not issue detailed, rigid regulations for security of lease sites. Rather, it should monitor the companies' performances in carrying out their own site security plans and should penalize violations.
- ° The oil and gas industry should carry out its obligation, as lessee, to pay royalties in full and on time. The industry, not the government, has primary responsibility for the detailed record-keeping needed to assure that all royalties are

paid. The industry also has the obligation to assure the security of lease sites. The industry, not the government, is best suited to develop effective site security plans, subject to the government's minimum standards.

If there is one concept that sums up the Commission's overall approach, it is accountability. Oil and gas companies must be held accountable for the obligations they undertake when they lease Federal and Indian lands for minerals production. The Federal government must be held accountable for fulfilling a public trust, that is, assuring that royalties for the Nation's energy resources are fully and fairly collected on behalf of the people of the United States.

The Federal government has not fulfilled this trust in the past 20 years. It is now taking steps to better its performance. Complex and demanding as the task may be, it is achievable if the internal controls, site security standards, and sanctions recommended here are made part of an improved royalty management system.